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C O N F I D E N T I A L SECTION 01 OF 03 DUBAI 000354

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DEPARTMENT FOR NEA/FO; NEA/ARP/BMCGOVERN

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SUBJECT: DUBAI SEEKS BOTTOM FOR ITS REAL ESTATE MARKET THROUGH CONSOLIDATION

DUBAI 00000354 001.2 OF 003

CLASSIFIED BY: Justin Siberell, Consul General.
REASON: 1.4 (b), (d)

¶1. (C) SUMMARY: Dubai Holding, the Dubai Inc. entity representing the personal property holdings of Dubai Ruler Sheikh Mohammed bin Rashid al Maktoum (MbR), plans to consolidate several of its largest property developers into one mega-sized integrated unit. Although news of the consolidation was announced in June and is part of a larger economic restructuring effort by the Government of Dubai, the details of the deal and implications on the broader real estate market have been slow to emerge and continue to stoke media intrigue. Along with measures to remove distressed property from the current market, consolidation of Dubai Inc's real estate holdings is also a key part of the government's attempt to put a floor on falling prices across the real estate sector. Meanwhile, external and internal investors continue to look for clear signs of a bottoming in Dubai's flagging real estate sector since consumer and residential property prices have fallen as much as 50 percent over the last year. END SUMMARY.

MAMMOTH CONSOLIDATION GOBBLES MARKET SHARE

¶2. (C) The plan by Dubai Holding, the parastatal run by Minister of Cabinet Affairs and key MbR advisor Mohammed Gergawi, to consolidate its real estate interests into to one mega-sized company has created an enormous market force, according to Martin Kohlhase, an Assistant Vice President at Moody's Investor Service. Kohlhase says the newly formed company will control close to 70 percent of the real estate market in Dubai and will have unrivaled access to Dubai's vast land bank once the deal closes by the end of 2009. Dubai Holding's consolidation of its Dubai Properties Group, Sama Dubai, Tatweer and upcoming merger with the government-owned Emaar Properties will create a company with a combined asset value of USD 53 billion. MbR personally owns 97.5 percent of Dubai Holding.

¶3. (C) The new company streamlines Dubai Holding's seven seemingly independent businesses into four distinct units, which will include a property unit, business parks, hospitality franchise and an investment arm. (Comment: A slimmed down and presumably more nibble Dubai Holding Properties unit would facilitate a cleaner merger with Emaar Properties. End Comment.) Kohlhase told econoff that the merger was also a sort of soft

landing for Emaar whose stock price has seen as much as an 80 percent decline since second half of 2008 and has undergone a major bankruptcy of its major U.S. subsidiary, John Laing Homes. Kohlhase said that with 13 years of property development experience and 14 thousand homes built in Dubai, Emaar properties has likely seen the last of its bull days as a stand alone company and would not see new large scale development projects down the pike, such as its current Burj Dubai development. Although the consolidation and merger attempts to streamline business units and retire many redundancies, the merger also leaves the new mega unit with presumably an enormous inherited debt load. Accurate figures on the exact value remain difficult to obtain.

CONSOLIDATION: AN ANSWER TO FALLING PRICES?

¶4. (C) In an August 25 meeting with econoff, Kohlhase suggested that the consolidation of Dubai Holding's real estate interests with Emaar Properties may be the Dubai government's attempt to create an artificial floor for prices in the real estate sector. Even if supply of properties continues to outstrip demand, he explained, developers can continue to charge high rents especially in their most expensive units if they no longer have to fear undercutting from rival developers within the Dubai Inc empire. The consolidation of Dubai's top real estate firms is a necessary thing for the market says Colliers International's Middle East CEO John Davis, especially in light of the severe price drops in rents and asset values over the last year. Davis told econoff that there continues to be a real oversupply of residential and commercial properties in the market (as much as

38,000 by years end, according to Paul Koster, Chief Executive of Dubai Financial Services Authority), which have led to declines in real estate values up to 50 percent across Dubai compared to this time last year.

¶5. (C) Davis suggested that the supply-demand balance in the property market will remain uneven in the near term, especially since many investors traditionally sit on their cash through the summer months, historically a slower period for real estate deals. Additionally, Kohlhase told EconOff in an earlier meeting that the supply in both commercial and residential properties is expected to double by 2011, without a similar increase in demand expected. The weakened demand also coincides with predicted declines of eight to 17 percent in Dubai's population in 2009 (resulting primarily from the departures of third country laborers), as noted by UBS and EFG Hermes banks, respectively. (Comment: Standard supply-demand models do not necessarily provide an accurate predictive tool in Dubai's case. Many real estate investors -- particularly Gulf Arabs and other wealthy individuals -- would rather remove a unit from the property market than rent or sell at a low price, and can afford to do so. Similarly, if the Dubai Government is the owner of much of the new real estate coming on the market, it can --presuming consolidated decision-making in this area -- regulate the number of units it chooses to put on the market in order to artificially maintain a desired supply-demand ratio. End comment.)

IN COME INVESTORS, OUT GO SPECULATORS

¶6. (C) Collier's International assesses that Dubai's real estate sector is undergoing a natural evolution from the largely speculator-end user driven market that made headlines in recent years to a more stable value investor driven market, where the price-to-yield gap continues to narrow from previously wide margins. According to Colliers, there has to be a necessary convergence of buyers and sellers in order for the price-to-yield gap on properties to achieve a reasonable margin to facilitate growth in deals, especially investor driven deals. Value investors, who now make up an increasing percentage of Dubai's real estate market, look for deals with depressed unit prices or average returns of between 25 and 40 percent in order to mitigate the still-outstanding risks in the market. It is not clear whether prices have fallen to a level that would guarantee those significant double-digit returns, especially with rents continuing to be depressed. Also, it remains to be seen what price point these value investors will eventually reach with the newly-consolidated Dubai Holding real estate venture that clearly would like to see prices stabilize and begin to move up.

DUBAI'S NEIGHBORS SEE OPPORTUNITIES

¶7. (C) The local and regional press report almost daily about investors from neighboring Gulf countries eyeing deals in Dubai's beleaguered real estate sector. However, the latest report that Kuwaiti-based investment fund, Al Mazaya Holding, announced plans to deploy as much as USD 100 million specifically to target distressed Dubai properties remains unverified. As Moody's and Colliers International suggested, the bulk of the real estate investors, most of whom are Dubai based, remain on the sidelines during the summer months and especially in light of the recent consolidations. Also, the speculation surrounding the potential high profile government bailout of Nakheel property development company has flamed the fires of uncertainty and complicated the prospects of a quick recovery. Nevertheless, in its press statements, Al Mazaya Holding insists that it sees this period of market depression as a real bottom for Dubai, especially in many of the high end property markets. Al Mazaya is planning investments in the Palm Jumeira, Burj Dubai and Dubai Investment Financial Center

(DIFC); entry into the distressed property market therefore may make sense for the company, as a depressed lower end of the market would likely delay eventual increases in the higher end properties it intends to target.

COMMENT

¶8. (C) The consolidation of Dubai Holding's property interests and the upcoming merger with Emaar Properties is welcomed by many market participants as an overdue "re-centralization" within Dubai Inc. The competition that developed over the past several years between rival real estate and development firms (and their ambitious CEO's) within the Dubai Inc empire may have

served the Dubai leadership's desire for "firing on all pistons" development, but came at the cost of coherence and, ultimately, sustainability. The market is very clearly over supplied, with thousands of additional commercial and residential units nearing completion. The consolidation is also therefore a measure intended by the Government to stabilize and locate bottom for a real estate sector that has been in freefall since the last quarter of 2008. END COMMENT.

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